

Indonesia Investments

‘Value-Added Tax to Be Raised?’

- Finance Ministry Proposing to Raise Indonesia’s VAT Rate, Possibly Introducing a Multi-Rate Model
- Part of Fiscal Consolidation Strategy; Government’s Budget Deficit Needs to Be Below 3% of GDP by 2023
- Many Doubt Whether Timing is Correct; COVID-19 Crisis Already Disrupted Consumption & Retail Trade
- Higher VAT Rate to Compensate for Generous Government Tax Incentives?
- Structural Problem for Indonesia’s Government Revenue Collection: Low Tax Ratio

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Preface

In addition to our reports, Indonesia Investments sends updates on key economic, political or social developments to our subscribers to make sure that our subscribers do not miss out on vital information. The topics in these updates will be discussed in more detail (and in an updated form) in the forthcoming report.

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Indonesian Government Plans to Raise the Country's Value-Added Tax (VAT) in 2022; An Example of Bad Timing?

While Indonesia is still in the middle of the COVID-19 crisis, albeit – most likely – set to exit the economic recession in the second quarter of 2021 due to the so-called low base effect, and while Indonesian consumers continue to display reluctance to spend (reflected by 16 consecutive months of contracting retail trade on an annual basis), the Indonesian government expressed its intention to raise Indonesia's Value-Added Tax (VAT, or in Indonesian: *Pajak Pertambahan Nilai*, abbreviated as PPN).

The proposal to raise Indonesia's VAT was set in the Indonesian Finance Ministry's 'Work Plan for the Year 2022'. This proposal is part of a fiscal reform program in the country's tax structure, aimed at raising tax revenue for the Indonesian government, and thereby bringing the central government's budget deficit back below 3 percent of gross domestic product (GDP) by 2023. Hence, it is an act of fiscal consolidation.

The Finance Ministry of Indonesia is looking for strategies to raise total tax revenue by around five percent year-on-year (y/y) from (an estimated) IDR 1.444.5 trillion (approx. USD \$101.4 billion) in 2021 to (at least) IDR 1,499.3 trillion (approx. USD \$105.2 billion) in 2022.

There are three key reasons why the Finance Ministry of Indonesia plans to raise the VAT rate.

- Indonesia's current VAT rate – with the standard at 10 percent – is low when compared to other countries. For example, the average VAT rate of countries within the European Union (EU) is 21 percent in 2021.
- So far, Indonesia has failed to optimize VAT revenue. It is estimated that Indonesia currently only generates 60 percent of its full potential in terms of VAT revenue. As a consequence, Indonesia's VAT-to-GDP ratio is quite low at an estimated 3.6 percent (lower than Thailand's ratio of 3.8 percent).
- By raising VAT revenue, the government will see a rise in overall tax revenue. This will help the budget deficit, which has widened significantly amid the COVID-19 crisis, to ease to normal levels. In 2021 the budget deficit is targeted at IDR 1,006.4 trillion (approx. USD \$70.6 billion), equivalent to 5.7 percent of GDP. Next year, in 2022, the budget deficit will still be rather wide at an estimated 4.7 percent of GDP. However, by law, the deficit has to be back below 3 percent of GDP by 2023 (based on Law No. 2 of Year 2020 on the State Budget).

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